

## Company Update

## Hai-O Ent

HAIO MK  
RM4.19

BUY (maintain)

Target Price: RM5.34 (↔)



## Price Performance

	1M	3M	12M
Absolute	-4.6%	+20.2%	+166.0%
Rel to KLCI	-5.6%	+13.2%	+97.3%

## Stock Data

Issued shares (m)	202.19
Mkt cap (RMm)	847.2
Avg daily vol - 6mth (m)	0.06
52-wk range (RM)	4.93-1.53
Est free float	65.7%
NTA per share (RM) (end-Jan 10)	1.0
P/NTA (x)	4.6
Net cash/debt (RMm) (end-Jan 10)	26.4
ROE (FY10F)	42.5
Derivatives	Nil

## Key Shareholders

Tan Kai Hee	9.6%
Akintan Sdn Bhd	7.2%

## Earnings &amp; Valuation Revisions

	10E	11E	12E
Prev EPS (sen)	38.3	47.6	54.2
Curr EPS (sen)	38.3	47.6	54.2
Chg (%)	-	-	-
Prev target price (RM)		5.34	
Curr target price (RM)		5.34	

Shakira Hatta  
(603) 2142 8158  
shakira@affinsecurities.com.my

## Making steady progress in core divisions

## Indonesian operations under-way: China will take awhile longer

Earlier this month, Hai-O officially launched PT Hai-O, the Indonesian arm of their MLM division. Although the company has had staff on the ground since Aug 09, the late launch was due to the slow nature of obtaining approvals from Indonesian authorities for some of its healthcare products. Management hopes to garner 10,000 distributors by end FY11, compared to the current 200. Aside from Indonesia, several newspaper dailies have also quoted MD Tan Kai Hee identifying China as Hai-O's next frontier for the MLM division. We believe this is a long-run goal and unlikely to materialize in the near future due to China's strict regulations with regard to direct selling business. Future foreign undertakings will also likely be dependent on the performance of PT Hai-O.

## In the meantime, earnings growth is driven by Malaysia MLM operations...

Locally, Hai-O's MLM division (which contributes c. 80% of topline) continues to drive earnings growth. Distributor force currently stands at 140,000. Active members make up about 15-20% of total distributors. We project MLM sales growth of +23.8% in FY11, underpinned by: 1) strong distributor activity due to highly attractive incentive trips; 2) introduction of new products, and; 3) overall improvement in consumer spending.

## ...and supported by sales of higher margin retail house brands

EBIT margin in the retail division has expanded substantially from 2.6% in FY06 to 7.6% in FY09. The improvement is due to Hai-O's focus on their own house brands, which currently accounts for over 40% of retail sales and commands higher margins than other non-house brand products. Furthermore, the retail division will likely record its highest ever revenue in 4QFY10, underpinned by improving consumer sentiment and strong Chinese New Year sales.

## Mulling over a share placement exercise to institutional investors

Having completed the 1-for-5 bonus issue and share split on 16 March 2010, Hai-O has one more corporate exercise on the drawing board, a private placement. Management has expressed interest in placing out shares to government-linked and Bumiputra institutions. Such a move, in our opinion, will help enhance Hai-O's status in the market and boost investor confidence.

## Maintain BUY, TP: RM5.34

Share price has retraced by 12% since reaching an all time high of RM4.68 (ex-all) on 19 March 2010. Valuations (based on FY11 PE of 8.8x) continue to look appealing, as stock is trading at a 13% and 32% discount to the MLM and consumer sector averages, respectively. We like Hai-O for its high dividend yields (FY10-12 average: 6.2%) and strong growth story. Maintain BUY and target price of RM5.34, pegged to a PER of 12x on CY10 EPS.

## Earnings and valuation summary

FYE 30 April	2008	2009	2010E	2011E	2012E
Revenue (RMm)	373.8	435.2	557.7	692.1	799.4
EBITDA (RMm)	68.1	77.0	113.3	139.1	158.5
Pretax profit (RMm)	67.7	75.9	108.2	133.9	153.3
Net profit (RMm)	48.5	52.3	77.6	96.5	109.9
EPS (sen)	23.9	25.8	38.3	47.6	54.2
EPS growth (%)	127.0	7.7	48.3	24.4	13.8
PER (x)	17.5	16.2	10.9	8.8	7.7
Core net profit (RMm)	48.5	52.3	77.6	96.5	109.9
Core EPS (sen)	23.9	25.8	38.3	47.6	54.2
Core PER (x)	17.5	16.2	10.9	8.8	7.7
GDPS (sen)	16.4	17.5	23.0	27.0	31.0
Dividend Yield (%)	3.9	4.2	5.5	6.4	7.4
EV/EBITDA (x)	11.3	10.2	6.7	5.2	4.3
Consensus profit (RMm)			78.6	94.8	105.5
Affin/Consensus (x)			1.0	1.0	1.0

**Indonesian operations under-way**

Earlier this month, Hai-O officially launched PT Hai-O, the Indonesian arm of their MLM division. Although the company has had staff on the ground since Aug 09, we gather that the late launch was due to the slow nature of obtaining approvals from Indonesian authorities for some of its healthcare products (i.e. Tongkat Ali Coffee). There are 6 products ready for distribution, with several more pending approvals. Products in Indonesia are priced, on average, 10% higher than in Malaysia, to account for import duties and transportation costs. In terms of distributors, management hopes to garner 10,000 distributors by end FY11 (as of April, there are 200 distributors in Indonesia). We lowered our FY10-11 earnings by 3-8% in our 9MFY10 results note dated 22 March 2010, taking into account: 1) the weaker 3QFY10 results due to a dip in sales post-campaign period, and 2) slower-than-expected distributor force growth in Indonesia. Despite the earnings downgrade, we still project a robust FY10 EPS growth of 48.3%.

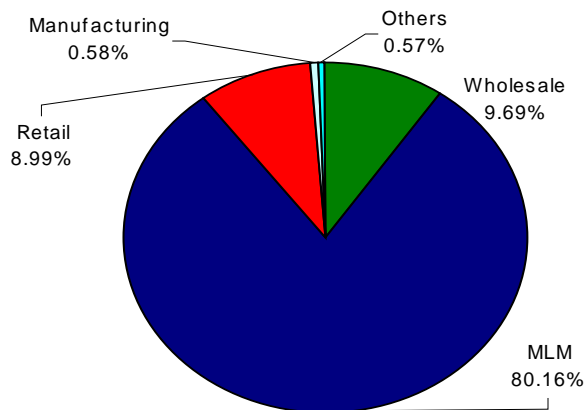
**MLM operations in China still a long shot**

Aside from Indonesia, several newspaper dailies have also quoted MD Tan Kai Hee identifying China as Hai-O's next frontier for the MLM division. While the sheer size of China's population offers massive potential, we believe this is a long-run goal and unlikely to materialize in the near future. China has strict regulations with regard to direct selling businesses. In addition to a registered capital of RMB80m (RM37.4m), the Chinese government also requires a guarantee deposit of RMB20m (RM9.3m) upon set-up of operations, a considerably larger sum compared to the paltry RM2m Hai-O forked out to begin operations in Indonesia. Future foreign undertakings will also likely be dependent on the performance of PT Hai-O, the company's first overseas venture.

**In the meantime, earnings growth is driven by domestic MLM operations...**

Locally, Hai-O's MLM division (which contributes c. 80% of topline) continues to drive earnings growth. Distributor force currently stands at 140,000. Active members (defined as those receiving commission for product sales) make up about 15-20% of total distributors. Nevertheless, we project MLM sales growth of +23.8% in FY11, underpinned by: 1) strong distributor activity underpinned by highly attractive incentive trips (destinations include Paris, Australia, China, Switzerland and a yearly Umrah package to Mecca for the predominantly Malay distributor base); 2) introduction of new products every 3-6 months (for higher-priced core products, such as the corsets and Bio-Aura water filter, Hai-O typically launches 1 new product a year), and; 3) overall improvement in the consumer environment in tandem with the economic recovery.

**Fig 1: Breakdown of FY09 revenue**

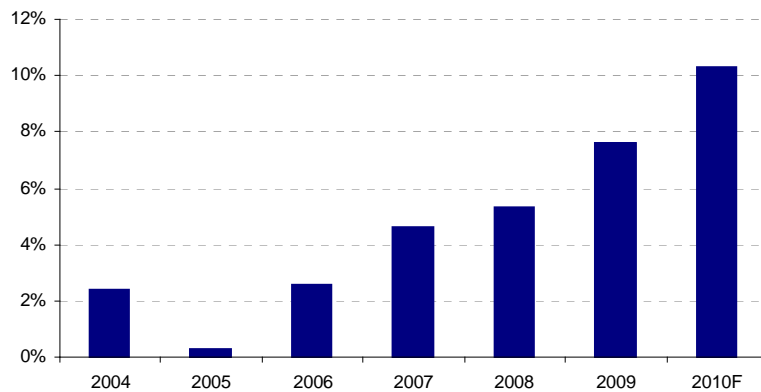


Source: Affin company data

**...and supported by sales of higher margin retail house brands**

Coming to prominence is Hai-O's retail division, which caters to the Chinese market and accounts for c. 9% of revenue. EBIT margin in the retail division has expanded substantially from 2.6% in FY06 to 7.6% in FY09. The improvement is due to Hai-O's focus on their own house brands, which currently accounts for over 40% of retail sales and commands higher margins than other non-house brand products. Furthermore, management guided that the retail division will likely record its highest ever revenue in 4QFY10, underpinned by the combination of improving consumer sentiment and strong Chinese New Year sales in February (results to be released in June).

**Fig 2: EBIT margin trend in the retail division**



Source: Affin, company data

**Mulling over placing out to institutional shareholders**

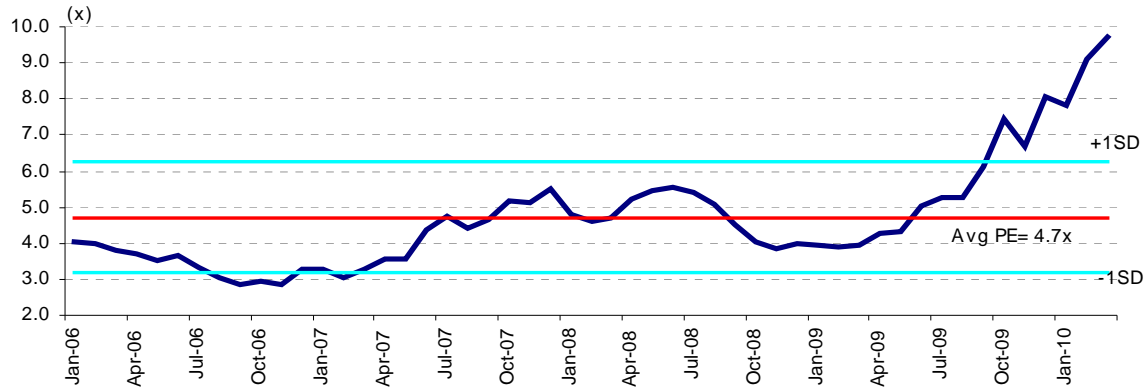
Having completed the 1-for-5 bonus issue and share split on 16 March 2010, Hai-O has one more corporate exercise on the drawing board, a private placement (10% of issued and paid-up share capital). Given Hai-O's net cash position (RM26.4m as at Jan 10), we believe this is targeted towards improving its share trading liquidity rather than raising funds. The potential investors, as well as a timeline for the placement have yet to be identified. With no institutional investors in the top 30 shareholders list, management expressed interest in placing out shares to government-linked and Bumiputra institutions. Such a move, in our opinion, will help to enhance Hai-O's credibility and status in the market and boost investor confidence in the stock.

**Maintain BUY, TP: RM5.34**

Share price has retraced by 12% since reaching an all time high of RM4.76 (ex-all) on 18 March 2010. Valuations (FY04/11 PE of 8.8x) continue to look appealing, as stock is trading at a 13% and 32% discount to the MLM and consumer sector averages, respectively. We continue to like Hai-O for its high dividend yields (FY10-12 average: 6.2%), centred on a minimum payout ratio of 50%, and strong growth prospects (we project 3-year FY09-12 EPS CAGR of 29%). Growth continues to be anchored by its Malaysia MLM operations (c. 95% of FY11 MLM revenue) while Indonesia is expected to remain tepid in the initial year of operations. Maintain BUY and target price of RM5.34, pegged to a PER of 12x on CY10 EPS. Key risks to our positive view are: 1) a slowdown in domestic MLM sales; 2) weaker-than-expected distributor force in Indonesia by end FY11; 3) slowdown in sales for the retail and wholesale division, and; 4) loss of distributors.

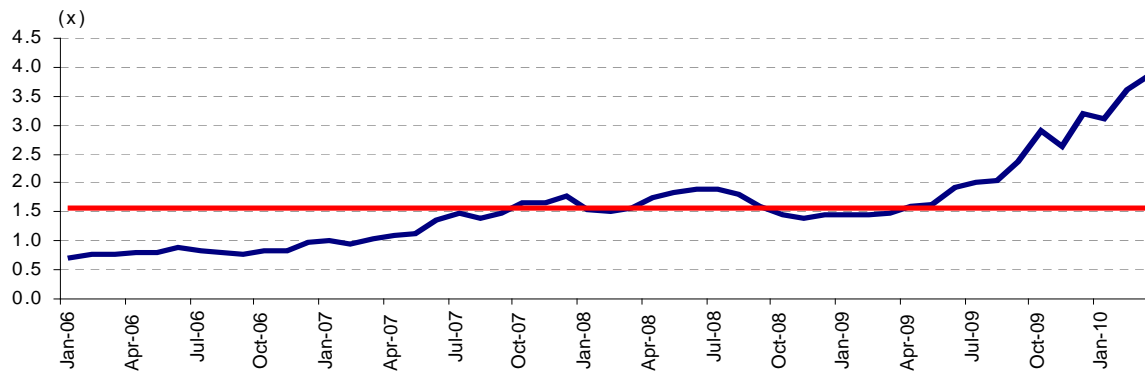
FOCUS CHARTS

Fig 1: Rolling PE trend



Source: Affin, Bloomberg

Fig 2: Rolling PBV trend



Source: Affin, Bloomberg

Fig 3: MLM peers comparison

	Rating	Sh Pr (RM)	TP (RM)	Market Cap (RMm)	PER (x)		EPS Growth (%)		ROE (%)		P/NTA (x)	Dividend Yield (%)	
					Pros. Yr 1	Pros. Yr 2	Pros. Yr 1	Pros. Yr 2	Pros. Yr 1	Pros. Yr 2		Pros. Yr 1	Pros. Yr 2
<b>Malaysia</b>													
HA-O	BUY	4.19	5.34	847.2	8.8	7.7	24.4	13.8	42.5	43.8	5.1	6.4	7.4
AMWAY	NR	7.45	na	1,224.7	13.6	13.8	(6.4)	1.3	34.7	30.8	5.4	6.7	6.7
ZHULIAN	NR	2.43	na	838.4	8.0	na	(11.5)	na	na	na	2.6	5.8	na
<b>Simple average</b>					<b>10.1</b>	<b>10.8</b>	<b>2.2</b>	<b>7.6</b>	<b>38.6</b>	<b>37.3</b>	<b>3.7</b>	<b>6.3</b>	<b>7.1</b>

Source: Affin, Bloomberg

Fig 4: Consumer sector comparison

Stock	Rating	Sh Pr (RM)	TP (RM)	Mkt Cap (RMm)	Year end	Core PE (x)		EPS growth (%)		EV/EBITDA (x)	P/B (x)	ROE (%)		Div. Yield (%)	
						Pros1	Pros2	Pros1	Pros2			Pros1	Pros2	Pros1	Pros2
AEON	REDUCE	5.00	4.81	1,755	Dec	11.7	11.0	6.8	6.7	4.1	1.6	13.1	12.6	3.0	3.0
BAT	ADD	43.30	44.27	12,363	Dec	15.7	15.1	4.6	4.3	11.3	120.5	142.1	129.9	5.7	6.0
BONIA	REDUCE	1.04	0.99	210	Jun	7.2	6.8	6.1	7.8	3.6	1.1	13.6	12.8	2.9	2.9
CARLSBERG	BUY	5.34	5.30	1,645	Dec	12.7	12.2	9.5	4.1	8.1	6.0	20.7	19.5	5.3	5.3
GUINNESS	BUY	6.95	8.87	2,100	Jun	13.2	12.3	5.2	7.3	8.3	4.6	32.5	32.2	5.9	6.5
HA-O	BUY	4.19	5.34	847	Apr	8.8	7.7	24.4	13.8	6.9	4.3	42.5	43.8	6.4	7.4
JTI	ADD	5.50	5.45	1,438	Dec	11.8	11.4	6.2	4.1	7.1	3.9	30.2	27.1	5.5	5.5
<b>Simple average</b>						<b>12.9</b>	<b>12.2</b>	<b>7.4</b>	<b>5.7</b>	<b>8.2</b>	<b>5.3</b>	<b>26.6</b>	<b>25.8</b>	<b>5.6</b>	<b>5.9</b>

Source: Affin, Bloomberg

## FINANCIAL SUMMARY – HAI-O ENTERPRISE

### Profit & Loss Statement

FYE 30 April (RMm)	2008	2009E	2010E	2011E	2012E
Revenue	373.8	435.2	557.7	692.1	799.4
Operating expenses	-305.7	-358.2	-444.5	-553.1	-640.9
EBITDA	68.1	77.0	113.3	139.1	158.5
Depreciation	-2.2	-2.5	-4.1	-4.4	-4.6
EBIT	65.9	74.5	109.1	134.7	153.9
Net int income/(expense)	-0.4	-1.2	-0.9	-0.8	-0.6
Associates' contribution	0.0	0.0	0.0	0.0	0.0
Pretax profit	67.7	75.9	108.2	133.9	153.3
Tax	-18.6	-22.9	-29.5	-36.0	-41.8
Minority interest	-0.6	-0.7	-1.1	-1.4	-1.6
Net profit	48.5	52.3	77.6	96.5	109.9

### Balance Sheet Statement

FYE 30 April (RMm)	2008	2009E	2010E	2011E	2012E
Fixed assets	21.6	59.4	60.9	62.0	62.9
Other long term assets	28.6	34.7	34.3	33.8	33.3
<b>Total non-current assets</b>	<b>50.2</b>	<b>94.2</b>	<b>95.2</b>	<b>95.8</b>	<b>96.2</b>
Cash and equivalents	73.3	50.7	73.7	105.4	145.0
Stocks	41.4	36.2	45.6	56.3	64.9
Debtors	25.7	36.3	46.5	57.7	66.6
Other current assets	13.6	30.8	30.8	30.8	30.8
<b>Total current assets</b>	<b>154.0</b>	<b>154.0</b>	<b>196.6</b>	<b>250.2</b>	<b>307.3</b>
Creditors	39.4	47.1	59.3	73.2	84.4
Short term borrowings	5.2	3.7	2.6	1.8	1.3
Other current liabilities	13.4	9.5	9.5	9.5	9.5
<b>Total current liabilities</b>	<b>58.0</b>	<b>60.4</b>	<b>71.5</b>	<b>84.5</b>	<b>95.2</b>
Long term borrowings	0.0	15.7	13.4	11.4	9.7
Other long term liabilities	0.1	0.1	0.1	0.1	0.1
<b>Total long term liabilities</b>	<b>0.1</b>	<b>15.8</b>	<b>13.5</b>	<b>11.4</b>	<b>9.7</b>
<b>Shareholders' Funds</b>	<b>140.6</b>	<b>165.7</b>	<b>199.4</b>	<b>241.2</b>	<b>288.2</b>
<b>Minority interest</b>	<b>5.5</b>	<b>6.3</b>	<b>7.4</b>	<b>8.8</b>	<b>10.3</b>

\*Changes in accounting policies to FRS 134

### Cash Flow Statement

FYE 30 April (RMm)	2008	2009E	2010E	2011E	2012E
EBIT	65.9	74.5	109.1	134.7	153.9
Depreciation & amortisation	2.2	2.6	4.1	4.4	4.6
Working capital changes	-4.0	-3.3	-7.4	-8.0	-6.4
Cash tax paid	-14.5	-24.5	-29.5	-36.0	-41.8
Others	4.2	4.1	14.7	12.2	12.7
<b>Cashflow from operation</b>	<b>53.8</b>	<b>53.4</b>	<b>91.0</b>	<b>107.2</b>	<b>123.0</b>
Capex	-34.7	-26.9	-20.0	-20.0	-20.0
Others	43.9	-14.8	0.0	0.0	0.0
<b>Cash flow from investing</b>	<b>9.2</b>	<b>-41.8</b>	<b>-20.0</b>	<b>-20.0</b>	<b>-20.0</b>
Debt raised/(repaid)	-0.7	-1.3	-0.9	-0.8	-0.6
Dividends paid	-12.4	-26.3	-46.6	-54.7	-62.8
Others	-4.3	-6.7	-0.5	0.0	0.0
<b>Cash flow from financing</b>	<b>-17.4</b>	<b>-34.3</b>	<b>-48.1</b>	<b>-55.5</b>	<b>-63.5</b>
<b>Free Cash Flow</b>	<b>19.1</b>	<b>26.5</b>	<b>71.0</b>	<b>87.2</b>	<b>103.0</b>

Source: Company data and Affin Investment Bank estimates

### Key Financial Ratios and Margins

FYE 30 April (RMm)	2008	2009E	2010E	2011E	2012E
<b>Growth</b>					
Revenue (%)	97.4	16.4	28.2	24.1	15.5
EBITDA (%)	120.2	13.1	47.0	22.8	14.0
Core net profit (%)	127.0	7.7	48.3	24.4	13.8
<b>Profitability</b>					
EBITDA margin (%)	18.2	17.7	20.3	20.1	19.8
PBT margin (%)	18.1	17.4	19.4	19.3	19.2
Net profit margin (%)	13.0	12.0	13.9	13.9	13.7
Effective tax rate (%)	27	30	27	27	27
ROA (%)	27.6	24.5	30.1	30.9	29.7
Core ROE (%)	39.4	34.1	42.5	43.8	41.5
ROCE (%)	50.9	45.0	54.5	57.3	55.6
Dividend payout ratio (%)	68.5	67.8	60.1	56.7	57.2
<b>Liquidity</b>					
Current ratio (x)	2.7	2.6	2.8	3.0	3.2
Op. cash flow (RMm)	53.8	53.4	91.0	107.2	123.0
Free cashflow (RMm)	19.1	26.5	71.0	87.2	103.0
FCF/share (sen)	9.4	13.1	35.0	43.0	50.8
<b>Asset management</b>					
Debtors turnover (days)	18.8	28.6	28.6	28.6	28.6
Stock turnover (days)	61.0	44.6	44.6	44.6	44.6
Creditors turnover (days)	13.1	9.7	9.7	9.7	9.7
<b>Capital structure</b>					
Net gearing (%)	net cash	net cash	net cash	net cash	net cash
Interest cover (x)	94.2	173.9	66.7	120.1	178.7

### Quarterly Profit & Loss

FYE 30 April (RMm)	3Q09	4Q09	1Q10	2Q10	3Q10
Revenue	102.1	132.8	148.6	132.4	131.3
Operating expenses	-83.5	-109.8	-122.3	-103.7	-106.1
EBITDA	18.6	23.0	26.3	28.7	25.2
Depreciation	0.0	0.0	0.0	0.0	0.0
EBIT	18.6	23.0	26.3	28.7	25.2
Net int income/(expense)	-0.1	-0.1	0.0	-0.1	0.0
Associates' contribution	0.0	0.0	0.0	0.0	0.0
Exceptional Items	0.0	0.0	0.0	0.0	0.0
Pretax profit	18.6	23.0	26.3	28.6	25.2
Tax	-6.2	-8.2	-7.8	-8.2	-7.0
Minority interest	-0.4	-0.1	-0.1	-0.3	-0.2
Net profit	12.0	14.7	18.5	20.2	18.0
Core net profit	12.0	14.7	18.5	20.2	18.0
<b>Margins (%)</b>					
EBITDA	18.2	17.3	17.7	21.7	19.2
PBT	18.2	17.3	17.7	21.6	19.2
Net profit	11.7	11.0	12.4	15.2	13.7

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#### Equity Rating Structure and Definitions

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<b>BUY</b>	Total return is expected to exceed +15% over a 12-month period
<b>TRADING BUY (TR BUY)</b>	Total return is expected to exceed +15% over a 3-month period due to short-term positive development, but fundamentals are not strong enough to warrant a Buy call. This is to cater to investors who are willing to take on higher risks
<b>ADD</b>	Total return is expected to be between 0% to +15% over a 12-month period
<b>REDUCE</b>	Total return is expected to be between 0% to -15% over a 12-month period
<b>TRADING SELL (TR SELL)</b>	Total return is expected to exceed -15% over a 3-month period due to short-term negative development, but fundamentals are strong enough to avoid a Sell call. This is to cater to investors who are willing to take on higher risks
<b>SELL</b>	Total return is expected to be below -15% over a 12-month period
<b>NOT RATED</b>	Affin Investment Bank does not provide research coverage or rating for this company. Report is intended as information only and not as a recommendation
<b>OVERWEIGHT</b>	Industry, as defined by the analyst's coverage universe, is expected to outperform the KLCI benchmark over the next 12 months
<b>NEUTRAL</b>	Industry, as defined by the analyst's coverage universe, is expected to perform inline with the KLCI benchmark over the next 12 months
<b>UNDERWEIGHT</b>	Industry, as defined by the analyst's coverage universe is expected to under-perform the KLCI benchmark over the next 12 months

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 Email : [research@affinsecurities.com.my](mailto:research@affinsecurities.com.my)  
 Tel : 603-2143 8668  
 Fax : 603-2145 3005